AMERICAN FINANCE AND THE EUROPEAN WAR

During the half-century that has elapsed since the Civil War, there has probably been no period of six months within which there have occurred transformations of so far-reaching a nature in American banking and finance as during the half-year between July 1, 1914, and January 1, 1915. It will be long before the full meaning and significance of these events are thoroughly understood; for what has been done cannot be finally interpreted until facts which have not yet been ascertained have developed their consequences. On the other hand, it would be impossible to forecast the ultimate effect of the European war should any one of certain tendencies which are still at least possible be fully carried out. What has already taken place, however, comprises a range of events full of important lessons and significant for the light they throw upon the methods to be employed in the near future in the management of industrial and commercial enterprises. This experience has been particularly rich in its bearing upon the relationship between banking and finance in the strict sense of the terms on the one hand, and the future of commerce and industry in general on the other. Though it be true that only hasty thinkers will endeavor to draw final conclusions from what has thus far occurred, it is, nevertheless, also true that much can be learned from the mere marshaling of recent events in their relation one to another.

I

Upon the outbreak of the European war, it was at once evident to all that very striking changes would result in every department of business life. There was, of course, at the outset no knowledge of the strategy or probable methods to be employed by any of the belligerents, and the general attitude of the business community was based upon the assumption that commerce would, for a time at least, become nearly impossible. As a corollary to that assumption, there prevailed the belief in many circles that American indebtedness to foreign countries would have to be liquidated in

cash, and that this process would result in draining away from the United States a corresponding amount of gold. It was natural, therefore, that the first phenomenon of the war should be the suspension of dealings which it was believed would promote this gold movement, or would cause more serious trouble in any direction than would otherwise be inevitable. The closing of the principal stock exchanges of the country almost immediately upon the definite announcement that war was unavoidable was thus dictated by two considerations: (1) the belief that prices for stocks and other securities would be reduced to a point so low as to bring about the repurchase of the securities by Americans, who would then be obliged to pay for them in gold; (2) the belief that, in consequence of this reduction of prices, many bank loans based upon securities would have to be "called," thereby bringing about failures and incidentally assisting in the movement of specie out of the country.

In the case of the cotton exchanges, it was at once perceived that the cotton crop, which is so largely produced for export, could not now move abroad with any degree of facility, and that the demand for cotton would undoubtedly be slack. The very fact of the war, therefore, implied heavy reductions in the price of cotton, and the closing of the cotton exchanges was a measure of self-preservation on the part of the operators, who decided to protect themselves against the inevitable failures which would result from the fulfilment of existing contracts at very low prices. To close the exchanges would result in gaining time, and would, therefore, enable operators to meet their maturing obligations, besides perhaps affording an opportunity for actual recovery in cotton prices. This very fact, however, of the closing of the exchanges and the consequent removal of any other established method of determining prices for standard securities and for a staple like cotton involved most profound and far-reaching effects. The exchanges had closed in previous years, but never for the reasons which now controlled them. That they should close because of the fear of failure and the loss of gold implied a serious danger of disaster which appealed powerfully to the public mind, and which presented a problem that could not be explained away. The fact that, coincident with this closing of the exchanges,

international trade was practically suspended for several days, and was seriously interrupted for several weeks, until British vessels assumed virtual control of the North Atlantic, tended greatly to increase the public anxiety. It formed, apparently, good ground for the suspension of business operations and for the non-fulfilment of contracts, even when the very difficult conditions did not themselves compel a recourse to such methods. The fact that foreign countries had adopted legislation deferring the date when debts need be paid or contracts fulfilled, although not paralleled here, produced a sympathetic influence upon business in the United States, which practically resulted in the partial or tentative adoption of a somewhat similar relaxation of commercial requirements in many industries and branches of trade.

It is notable that the Produce Exchange of New York and the other grain exchanges of the country continued in operation and did an enormous business in spite of the prevailing conditions. This was due to the fact that grain of all kinds, provisions, and every sort of food-stuff were, for the time being, subject to a very rapid upward movement. It was early perceived that a long continuance of the war would bring about a steady advance in the prices of all food products, the markets for which are not dependent upon temporary fluctuations for support, but are subject to far-reaching and semi-permanent influences. The fact that these exchanges continued open while those whose staples were subject to decline closed so speedily, naturally produced its own effect upon the public mind. Many who had thought the exchanges invariably faithful registers of price fluctuations were now reluctantly obliged to confess that this could not be the case, since those exchanges where prices were rising continued to operate without interruption, while those where prices were falling were obliged to suspend business. From one point of view, undoubtedly, the closing of the stock and cotton exchanges tended still further to deepen the attitude of dissatisfaction with these institutions that had been prevalent for some years among the American public. On the other hand, however, as time went on, it became clear that the exchanges of the country and the service they performed when in operation were being appreciated as never before by the con-

servative popular mind of the nation. With the exchanges closed it was seen that the lack of a regular and established market subject to natural conditions meant suffering and inability to secure the advantage of free competition in the establishment of the price of products. This view was once more emphasized when, later on, the cotton exchanges reopened; for it was then seen that the effect of trading upon the exchanges was to advance the price of the staple rather than to lower it, a view the precise reverse of that which had been originally prevalent for a long time past. Both in the psychological, as well as in the actual, effect of these closings, and in the influence the episode exerted upon public opinion, the suspension of the exchanges throughout the United States must be regarded as a fact of first-rate importance in the financial history of the United States during the European war.

II

Even without the suspension of certain classes of trading throughout the country, partially due as it was to the frenzied demand of European holders of American investments for money, the strain thrown upon our banks as a result of the great change in conditions would have been enormous. The closing of the exchanges, as already seen, had relieved matters to some extent by enabling the banks to avoid the calling of loans, and thereby to avoid the necessity of forcing customers into liquidation, with the resultant disastrous effect upon themselves. But on the other hand, the suspension of operations and the corresponding loss by the public would, it was felt, tend to the hoarding of legal-tender money. In order to meet this situation, the banks in many of the large financial centers sought to limit specie payments, taking out emergency currency and clearing-house certificates for the purpose of meeting their indebtedness to the public and to one another. The national currency associations, which had numbered only eighteen up to the beginning of the European war, rapidly increased until they aggregated forty-four; and prompt preparations were made in Washington for supplying emergency currency, under the terms of the Federal Reserve act, to any such association as might need the notes. At the same time,

practically all of the clearing-house associations of the larger cities arranged for the issuing of certificates. Congress, still further to facilitate the work, adopted on August 4 and 15 measures amendatory to the Federal Reserve act, which had itself amended and extended the Aldrich-Vreeland law. Under these latest amendments, very much greater latitude was given for the issuing of currency, and the cost of such issues was reduced by lowering the rates of taxation collected upon such emergency issues. These acts practically gave free range to the taking-out of emergency bank notes, and during the weeks succeeding their adoption, and prior to the opening of the new federal reserve banks, more than $350,000,000 was issued, the ultimate amount of the issues aggregating $380,000,000. How many clearing-house certificates were taken out is not known and cannot fairly be estimated; but it is probably well within the truth to say that they amounted to as much as, if not more than, the original issue of emergency currency. It would be a conservative statement, no doubt, to say that fully $700,000,000 of new media was injected into circulation within a short time.

Obviously no field could have been found for the use of so great a total of new notes had there not been a more than equal withdrawal in other directions. Business was almost paralyzed at the outset, and has been more or less slack ever since. There has been no time when the call for a full currency supply was as great as it was before the European war. Fully $700,000,000, then, of lawful money must have been hoarded either by banks or by individuals. This, in fact, is doubtless what occurred, banks hoarding the cash by withholding it, so far as possible, both from one another and from the public; while the public hoarded lawful money by retaining it as it came into its possession, and applying to the banks for more supplies of circulating media, which were furnished in the form of emergency currency, made so plentifully available. Thus were placed in evidence two great phenomena of the financial crisis throughout the United States—the withdrawal of the usual forms of money, and the substitution for them of emergency notes protected, of course, by ample security in the form of commercial paper, but, so far as redemption was concerned,

backed only by a small reserve specifically set apart for them in the Treasury. A phase of this phenomenon was seen in the tremendous rise in foreign exchange rates, the rates becoming practically prohibitive and thereby causing what amounted to a suspension of financial relationship between the United States and foreign countries, particularly Great Britain.

III

It was early understood that the real difficulty and danger in the international situation did not lie in the superficial symptoms of trouble, but were found much deeper, being directly due to the fact that international business had been practically suspended as the result of the war. This was a factor of prime and material importance in the whole situation, because the maintenance of established relations between the United States and foreign countries was directly dependent upon the regular exportation of goods. As was customary during the summer months, there had been large expenditures by American tourists in Europe; and we had become indebted to other countries, particularly Great Britain, for material sums in excess of what we were currently able to liquidate. This was on the assumption, as usual, that such indebtedness would be liquidated through the shipment of agricultural products, particularly of cotton, the country's principal cash crop. The breakdown of trade with Europe through the inability of vessels to run regularly at the outset of the war, and through the reduction of buying power, due to the interruption of all regular industrial, commercial, and financial operations, meant that in the absence of some restoration of the normal course of business it would be necessary to find other means of liquidating our obligations to foreign countries. The first phase of the difficulty was met by investigating the extent of international indebtedness, which, in the absence of other means of payment, would necessitate the draining-away of gold from the United States. Such an investigation was undertaken by the Federal Reserve Board, which, by sending out questions to the principal international bankers of the country, succeeded in forming a more or less trustworthy estimate of the indebtedness on current accounts,

these being, of course, of varying maturities extending over several months. The problem thus raised was how to provide for liquidating the debts without losing so much of the underlying gold supply as to impair the convertibility of American securities, and therewith general confidence in American ability to meet obligations. The two chief proposals put forward for bridging over the period of difficulty were the establishment of a joint gold fund by the bankers of the country, and the undertaking of negotiations with Great Britain whereby some relaxation of foreign demands on the United States might be arranged for. These two phases of policy may best be cursorily sketched at this point.

Since the new banks had not yet been established and could not be put into operation for some weeks, it was deemed desirable to furnish a makeshift substitute for the co-operative effort which would have been available for the relief of the situation had the banks been in existence. It was therefore determined to suggest to a number of representative bankers the establishment of a joint gold fund to be used in providing exchange on Great Britain, and to have this joint fund developed at the earliest possible moment. A letter was consequently sent out to the presidents of clearing-house associations throughout the country, under date of September 21, in which request was made for subscriptions to a fund intended to aggregate about one hundred million dollars. This letter had previously been considered and approved at meetings of representative bankers summoned to meet in Washington on September 4 and 19 respectively, and was, therefore, issued with their moral support. The answer to this invitation was prompt and effective, a total of over one hundred and eight million dollars being subscribed and rendered available.

It was almost immediately evident that the operation of this fund was proving decidedly beneficial notwithstanding that only a comparatively small percentage of the amount subscribed was asked for, and that a still smaller percentage was actually used to furnish a basis for gold shipments. Nevertheless, it seemed, during the ten days immediately following the completion of the subscriptions, as if there might be need for still further relief to the situation. Some of those who were closely connected with the

administration of the gold exchange fund brought the subject to the attention of the Secretary of the Treasury and he extended an invitation to the British government to send representatives to this country mainly for the purpose of considering the possibility of further adjustment, in the event that the United States did not succeed in liquidating its indebtedness to Great Britain by the natural movement of commodities within a reasonably early period. The British government designated Sir George Paish and Mr. B. P. Blackett, who came to the United States and on October 23 held a conference with the Federal Reserve Board. Subsequently another conference, attended by a number of representative bankers, was also held and the situation was discussed in very great detail. Meantime the establishment of a better understanding with reference to commodities to be considered as contraband and the more effective policing of the North Atlantic rendered possible the restoration of trade with European nations, and the development of the export trade proceeded with a speed which showed that current obligations of the United States to Great Britain and other countries would be liquidated at an early date without any necessity for further interference. By the time the reserve banks were ready to open, exchange sales on London had fallen to normal, and there was, therefore, no danger that when opened the reserve banks might, as was for a time feared by some, find their gold rapidly drawn away from them in order to meet the requirements of the gold export movement.

In another way it was deemed desirable that the Federal Reserve Board should help to facilitate the restoration of customary conditions in the financial market. Almost immediately after the outbreak of war it was seen that, unless hostilities should terminate within a very much shorter period than anyone thought likely, serious injury would be inflicted upon the cotton-producing states. As is well known, the cotton crop is largely grown for export, about two-thirds of the total production of the United States being annually sold abroad. It happened that an unusually large crop had been planted and was approaching maturity at the moment of the outbreak of the war. This would in any event have depressed prices of cotton, even under ordinary conditions. The almost

immediate closing of the cotton exchanges of the country was, however, precipitated by reason of the interruption to the movement of cotton and the general understanding that, in view of the great area involved in the hostilities, it would not be reasonable to expect a normal demand for the staple to manifest itself. With the exchanges closed, and with shipments of cotton interrupted, the price was unstable and abnormally low, many sales undoubtedly having occurred at five cents per pound. Inasmuch as the cotton crop is raised very largely upon credit, it was necessary to provide some means whereby the southern planter could be assisted to such extension of accommodation as he might require in meeting the obligations he would ordinarily have provided for by the sale of his crop in the open market. Various suggestions were brought to the attention of the Federal Reserve Board, one of them being that of Mr. Festus J. Wade of St. Louis, who suggested, both to the Board and to the Secretary of the Treasury, the establishment of a cotton loan fund somewhat similar in purpose and management to the gold exchange fund. After very anxious consideration, the conclusion was reached that some measure of the sort would probably furnish relief to cotton-growers. Various conferences were held with banking interests for the purpose of securing their co-operation and advice in regard to the matter. Ultimately the bankers of New York pledged fifty million dollars in subscriptions to the fund, provided that fifty millions more should be raised from other bankers in non-cotton-producing states. It was understood that to the one hundred million dollars thus raised should be added thirty-five million dollars contributed by the bankers of the cotton-producing states under a special plan devised for that purpose.[1]

IV

It was not, however, through any of these artificial means that real relief was brought to the community. While bankers were laboring to perfect the gold fund, and while the negotiations with Great Britain were in progress, foreign trade was being

[1] A fuller account of the gold fund and cotton loan plans will be found in the *First Annual Report of the Federal Reserve Board*, Washington, January 15, 1915.

re-established through the effective policing of the North Atlantic, the re-establishment of demands, and the resumption of the ordinary course of business. What took place during the months of August and September can be understood from the comparative figures for importation and exportation which make an impressive showing of the suffering to which the United States was subjected through this decline in business. With the opening of October there came, however, a decided improvement. Time had now been given for the establishment of normal conditions. From that date the figures for foreign trade are worthy of study in detail, more particularly as never before have they been available by weekly periods.

Table I shows the gradual restoration of exports and the growth of a balance in favor of the United States. The figures which have thus been compiled show the steady increase of exports, indicating the resumption of normal trade. They also show—and this is the significant feature of the tabulation—the steady growth of the surplus of exports over imports. The sum of these surpluses indicates the rate at which the United States was able to pay off its indebtedness to foreign countries by the natural process of sending goods to them. For the month of November the showing becomes especially impressive and interesting, as by that time the movement of recovery had had sufficient opportunity to make headway to an extent warranting the belief that trade had been definitely restored to its natural level. Very detailed analysis of these figures would be interesting; but it is probably sufficient to comment at this point upon figures for the month of November as compared with the preceding period of the years 1914 and 1913.

The imports for November, 1914, totaled $126,467,007, against $138,080,520 in October, $139,710,611 in September, and $129,-767,890 in August, and were $21,769,529 less than in November, 1913. In November, 1914, exports totaled $205,766,424, against $194,711,170 in October, $156,052,333 in September, and $110,367,-494 in August, and were $39,772,618 below those for November, 1913. This falling-off included a decrease of $71,401,324 in cotton, all other articles, as a whole, showing a net increase of $31,628,706. The excess of exports over imports for November, 1914, was

$79,299,417, compared with $56,630,650 in October, $16,341,722 in September, and an import balance of $19,400,406 in August. Of the November imports, 62.1 per cent entered free of duty,

TABLE I

IMPORTS AND EXPORTS AT THE PRINCIPAL CUSTOMS DISTRICTS FOR THE MONTHS OF OCTOBER, NOVEMBER, AND DECEMBER

Districts	Imports	Exports	Imports	Exports
	Week ending October 10		Week ending October 17	
Massachusetts (Boston)....	$ 2,192,374	$ 2,365,133	$ 2,543,606	$ 1,564,406
New York..............	18,346,168	17,969,983	17,109,271	15,139,582
Philadelphia.............	1,063,657	1,612,066	1,468,513	403,264
Maryland (Baltimore).....	417,440	2,479,548	366,901	1,348,598
New Orleans............	1,777,788	2,463,275	483,110	3,093,045
Galveston...............	298,215	4,459,871	95,688	2,877,608
San Francisco...........	737,735	544,459	946,329	1,125,863
Washington (Seattle)......	2,388,502	876,952	972,785	214,024
Buffalo.................	936,012	2,118,457	435,837	1,139,138
Michigan (Detroit)........	651,110	No data	351,318	1,727,933
Total...............	$28,809,001	$34,889,744	$24,773,358	$28,633,461
	Week ending October 24		Week ending October 31	
Massachusetts (Boston)....	$ 2,560,383	$ 1,356,599	$ 1,412,730	$ 2,369,386
New York..............	16,406,210	21,410,546	17,294,322	23,279,869
Philadelphia.............	1,167,244	1,253,533	1,179,982	1,279,917
Maryland (Baltimore).....	804,574	988,247	482,725	1,509,004
New Orleans............	1,067,652	2,499,532	842,224	3,521,054
Galveston...............	295,574	2,842,729	129,025	7,141,548
San Francisco...........	4,618,521	3,418,508	1,165,620	2,073,911
Washington (Seattle)......	971,819	1,754,444	1,252,996	965,757
Buffalo.................	602,309	1,091,979	521,493	1,548,617
Michigan (Detroit)........	457,689	1,582,499	369,388	2,206,509
Total...............	$28,951,975	$38,198,616	$24,650,505	$45,895,572

Districts	Imports	Exports	Imports	Exports
	Week ending November 7		Week ending November 14	
Massachusetts (Boston)....	$ 1,296,829	$ 2,477,461	$ 1,718,443	$ 2,929,324
New York..............	16,627,215	17,971,935	16,656,206	24,164,987
Philadelphia.............	954,412	1,809,165	997,543	1,889,552
Maryland (Baltimore).....	455,630	2,751,189	443,641	3,300,981
New Orleans............	1,649,529	1,456,047	1,292,414	3,567,787
Galveston...............	192,159	4,641,310	544,957	5,430,332
San Francisco...........	1,944,448	1,310,046	698,444	1,718,190
Washington (Seattle)......	1,928,607	926,805	1,837,199	1,097,999
Buffalo.................	723,018	1,266,249	942,436	1,178,543
Michigan (Detroit)........	358,048	2,035,560	579,705	2,309,635
Total...............	$26,129,895	$36,645,767	$25,710,988	$47,587,330

TABLE I—*Continued*

Districts	Imports	Exports	Imports	Exports
	Week ending November 21		Week ending November 28	
Massachusetts (Boston)	$ 988,964	$ 956,457	$ 2,326,155	$ 1,687,779
New York	18,033,382	19,833,708	17,156,099	17,578,812
Philadelphia	1,122,742	1,958,644	770,450	1,471,081
Maryland (Baltimore)	623,558	2,638,692	263,209	2,866,686
New Orleans	822,988	2,188,007	892,153	4,928,470
Galveston	201,775	5,946,181	176,284	6,158,622
San Francisco	1,719,208	1,232,975	678,694	2,474,085
Washington (Seattle)	342,852	1,215,437	2,155,709	1,535,091
Buffalo	384,742	1,115,124	1,157,323	1,175,280
Michigan (Detroit)	593,913	2,132,312	340,926	2,150,509
Virginia (Norfolk)	....	....	134,706	1,070,158
Chicago	....	....	633,849	279
Total	$24,834,124	$39,217,537	$26,685,557	$43,098,852

Districts	Imports	Exports	Imports	Exports
	Week ending December 5		Week ending December 12	
Massachusetts (Boston)	$ 927,186	$ 3,761,361	$ 1,714,398	$ 2,017,940
New York	16,496,862	20,029,048	16,811,612	23,512,539
Philadelphia	936,333	1,961,983	660,879	1,857,063
Maryland (Baltimore)	177,484	2,073,541	359,187	1,436,449
Virginia (Norfolk)	141,301	80,407	142,999	59,041
New Orleans	1,136,162	5,143,233	637,912	3,748,359
Galveston	146,490	9,095,744	230,560	6,970,645
San Francisco	1,832,893	818,538	1,075,183	2,032,906
Washington (Seattle)	869,188	1,415,196	905,286	994,016
Buffalo	967,008	592,323	791,482	1,080,941
Chicago	785,295	70,000	637,756	....
Michigan (Detroit)	552,082	1,779,252	461,192	1,708,033
Total	$24,968,284	$46,820,626	$24,428,446	$45,417,932
	Week ending December 19		Week ending December 26	
Massachusetts (Boston)	$ 1,413,076	$ 1,532,375	$ 2,468,535	$ 3,665,480
New York	13,955,724	20,092,628	12,002,118	15,105,813
Philadelphia	858,645	757,302	1,013,303	1,656,320
Maryland (Baltimore)	372,146	3,938,553	359,014	695,309
Virginia (Norfolk)	78,749	1,101,196	111,714	731,644
New Orleans	1,909,454	6,593,949	478,634	3,782,735
Galveston	161,424	8,130,528	114,091	6,740,120
San Francisco	706,062	1,517,912	544,734	1,477,250
Washington (Seattle)	1,377,838	784,966	820,429	493,670
Buffalo	572,729	1,262,240	414,232	1,025,603
Chicago	579,590	....	446,592	....
Michigan (Detroit)	426,004	1,564,182	472,787	1,564,207
Georgia	538	2,164,411	13,739	1,729,578
Total	$22,411,979	$49,440,242	$19,259,922	$38,667,729

against 61.7 per cent in November, 1913, and 58.6 per cent in November, 1912. Comparing the trade movements in the eleven months ended November 30, 1914, with those of a like period of 1913, imports for 1914 showed a total of $1,674,619,401 against

TABLE II

Groups	Month of November		Eleven Months Ended with November	
	1913	1914	1913	1914
IMPORTS				
Crude materials for use in manufacturing	$ 46,789,621	$ 38,120,210	$ 542,499,782	$ 563,731,584
Food-stuffs in crude condition and food animals	25,371,847	19,836,436	190,868,307	216,771,040
Food-stuffs partly or wholly manufactured	15,575,722	13,482,343	181,583,295	240,089,283
Manufactures for further use in manufacturing	23,784,351	21,436,283	311,982,083	259,838,694
Manufactures ready for consumption	35,149,509	31,858,958	368,822,918	378,625,288
Miscellaneous	1,565,486	1,732,832	12,814,524	15,563,567
Total imports	$148,236,536	$126,467,062	$1,608,570,909	$1,674,619,456
EXPORTS				
Crude materials for use in manufacturing	$118,225,262	$ 42,346,511	$ 671,565,045	$ 433,385,903
Food-stuffs in crude condition and food animals	8,879,251	36,890,642	159,610,372	223,655,840
Food-stuffs partly or wholly manufactured	29,908,437	36,158,374	297,025,563	271,146,186
Manufactures for further use in manufacturing	28,146,671	25,669,658	367,123,279	316,130,287
Manufactures ready for consumption	57,654,126	53,238,328	715,071,449	572,782,902
Miscellaneous	561,321	5,704,710	7,405,425	13,312,420
Total domestic exports	$243,375,068	$200,008,223	$2,217,801,133	$1,830,413,538
Foreign merchandise exported	2,163,974	5,870,110	33,021,531	37,577,954
Total exports	$245,539,042	$205,878,333	$2,250,822,664	$1,867,991,492

$1,608,570,909 for 1913; and exports for 1914, $1,867,879,583 against $2,250,822,664 for 1913. Imports of gold in November, 1914, totaled $7,391,729, against $7,040,782 in November, 1913; and in the eleven months, $53,278,678, against $58,631,475 in the corresponding period of 1913. Gold exports in November, 1914,

aggregated $14,526,482, against $6,662,958 in November, 1913; and in the eleven months, $222,485,232, against $81,226,017 in the same months of 1913.

By way of summary may be cited the comparative figures for the month of November, 1914, and for the eleven months preceding, as classified by groups of articles (Table II).

Thus while trade for the period in question was below its normal level, it is seen that the decline was largely in a limited group of articles, whose foreign demand had been impaired by the unusual and abnormal conditions existing abroad.

V

With foreign trade in a fair way to recover, it was still necessary to secure a restoration of normal trade conditions within the United States, and for this purpose the thing most fundamentally necessary was the setting in motion of the federal reserve banking system which had been provided for by act of Congress the 23d of December preceding. The time intervening between December 23, 1913, and the opening of the war had been occupied in carrying out the preliminaries of organization; but it still remained for the Federal Reserve Board, the controlling mechanism of the new system, to appoint officers and to provide for the active operation of the banks under its direction. The first detail to which the Board necessarily addressed itself was the completion of the boards of directors of the several institutions, it being necessary to select and elect three in each institution, or thirty-six in all. The task required an elaborate process of comparison of the names and qualifications of the several candidates and was not completed until early in October. With the announcement of the thirty-six directors, it was possible to proceed to the active opening of the institutions. The Board called for the first payment of capital stock on November 2, and the Secretary of the Treasury, who by law had been vested with that function, named November 16 as the actual date for opening.

In view of the urgent character of the situation regarding the establishment of the banks, it was not considered possible to formulate in advance of their opening a complete set of regulations with

reference to their conduct in all matters, and the Board determined to pass at the outset upon those matters only which were deemed absolutely essential to placing the banks immediately in operation. It was felt that the regulations concerning discount operations and commercial paper in general were fundamental, and that they should be granted first place in any scheme of organization which might be undertaken. The result was the preparation of a document addressed to all federal reserve agents, sent to them as *Circular No. 13*, in which the Board set forth its views with reference to the character of operations that should be undertaken by the banks, particularly at the outset. In this it was recommended that the reserve banks confine themselves strictly to short-term, self-liquidating paper growing out of commercial, industrial, and agricultural operations, in the narrow sense of the terms, and that particular care should be taken not to discount or purchase paper which had been issued for the primary purpose of increasing the capital investment of any business.[1]

It was considered of primary importance that, so far as possible, the cash to be paid into the banks at the outset should be drawn from the vaults of the contributing member banks. Inasmuch as the act provided that capital should be paid in gold or gold certificates, it was to be assumed that the bulk of such payments would, in any event, be made from the vaults of the member banks. Reserves, however, might, of course, be paid in any form of lawful money; and the act itself had expressly provided that one-half of the reserve instalments might be paid in the form of rediscounted paper. It was therefore necessary to appeal to the good judgment and spirit of co-operation of the member banks, in order to induce them to abstain from establishing reserves through some means other than that of a direct deposit of cash from their own vaults, and to pay, so far as possible, the sums that were due from them to the reserve banks on reserve account in the form of gold or gold certificates. With this in mind, the Board transmitted to member banks on October 28 its *Circular No. 10*, in which banks were urged to make their payments in the manner already indicated. As a special inducement, reserve banks were authorized

[1] Cf. *First Annual Report of the Federal Reserve Board*, p. 9.

to pay the express charges upon the sums thus sent to them by member banks.

The consolidated statement issued on the Saturday following the opening of November 16, and showing the condition as of the evening previous, indicates how fully the banks complied with the suggestions thus made to them. The statement referred to, constituting the first of the weekly statements issued by the Board in accordance with the Federal Reserve act, is herewith presented in tabular form (Table III). It shows that at the end of the first week's

TABLE III

STATEMENT OF COMBINED RESOURCES AND LIABILITIES OF THE FEDERAL RESERVE BANKS OF THE UNITED STATES OF AMERICA AT THE CLOSE OF BUSINESS NOVEMBER 27, 1914

Resources	November 27, 1914	November 20, 1914
Gold coin and certificates	$227,840,000	$203,415,000
Legal-tender notes, silver certificates, and subsidiary coin	34,630,000	37,308,000
Total	$262,470,000	$240,723,000
Rediscounts and loans	$7,383,000	$5,607,000
All other resources	165,000	95,000
Total resources	$270,018,000	$246,425,000
Liabilities		
Capital paid in	$ 18,050,000	$ 18,072,000
Reserve deposits	249,268,000	227,138,000
Federal reserve notes in circulation	2,700,000	$ 1,215,000
Total liabilities	$270,018,000	$246,425,000
Gold reserve against all liabilities	90 per cent	89 per cent
Cash reserve against all liabilities	104 per cent	105 per cent
Cash reserve against all liabilities after setting aside 40 per cent gold reserve against federal reserve notes in circulation	103.70 per cent	105 per cent

Memo.

Discount and loan maturities	
Within 30 days	$5,857,000
Within 60 days	1,097,000
Other	429,000
	$7,383,000

operations there had been paid into the reserve banks a total of $221,880,000, of which a very large percentage was either in gold

or in gold certificates. Owing to the co-operation of the member banks, this transfer was accomplished without danger or inconvenience.

The question of a discount policy had next to be disposed of, for it was generally conceded that the adoption of a uniform, consistent policy to be pursued by all was practically necessary to the smooth working of the system. Each reserve bank submitted its views with respect to the rate of discount properly to be applied in its region, but upon tabulation and comparison of these results, it was found that they varied comparatively little, the rates ranging from 5 to 7 per cent. A study of the existing state of affairs convinced the Board that at the start conservatism should be the guiding policy in establishing discount rates, and it was consequently voted to set the rates of discount at from $5\frac{1}{2}$ to $6\frac{1}{2}$ per cent, with subsequent changes, as shown in Table IV.

TABLE IV

Federal Reserve Bank	Date of Last Change of Rate	Maturities of 30 Days and Less	Maturities of Over 30 Days to 60 Days Inclusive	Maturities of Over 60 Days to 90 Days Inclusive	Agricultural and Live Stock Paper of Over 90 Days
	December 1914	Per Cent	Per Cent	Per Cent	Per Cent
Boston........	30	$4\frac{1}{2}$	5	5	6
New York.....	28	$4\frac{1}{2}$	5	5	6
Philadelphia ...	28	$4\frac{1}{2}$	5	5	6
Cleveland	15	5	$5\frac{1}{2}$	6	6
Richmond.....	28	5	5	$5\frac{1}{2}$	6
Atlanta.......	28	5	5	$5\frac{1}{2}$	6
Chicago.......	January 1, 1915	$4\frac{1}{2}$	5	$5\frac{1}{2}$	6
	December 1914				
St. Louis......	21	5	$5\frac{1}{2}$	6	6
Minneapolis ...	24	5	$5\frac{1}{2}$	6	6
Kansas City ...	15	5	$5\frac{1}{2}$	6	6
Dallas........	30	5	5	$5\frac{1}{2}$	6
San Francisco..	30	$4\frac{1}{2}$	$5\frac{1}{2}$	6	6

The important effect of the establishment of these rates of discount was to prevent accommodation from being asked by member banks except in those cases where there was a real need for it, since the rates were too high to encourage the borrowing of funds from the reserve institutions simply for the sake of undertaking new operations or of extending those already in existence. As was

expected, therefore, the amount of accommodation applied for at most of the banks was relatively small.

The establishment of the system had, however, greatly relieved the banking situation even without such loans at the reserve banks. Sec. 19 of the Federal Reserve act provided for a readjustment of reserves upon a new and lower basis, cutting the percentage of required reserve in central reserve cities from 25 to 18 per cent of outstanding demand deposits, with 5 per cent outstanding time deposits; the required percentage in reserve cities from 25 to 15 per cent of demand deposits and 5 per cent time deposits; the percentage of reserve in country banks from 25 to 12 per cent on demand deposits and 5 per cent time deposits. This readjustment, by the terms of the law, took effect immediately upon the establishment of the new banks, i.e., on November 16. From the outbreak of hostilities in Europe, there had been a difficult reserve situation in most of the financial centers, New York banks particularly being much of the time largely under their reserve requirements because of the heavy drafts made upon them by interior banks and by the public. The change in reserve requirements, however, made a very material alteration in this condition of affairs, and released, not only in New York, but throughout the country, a very considerable amount of funds which had previously been held by the banks in order to bring themselves within the requirements of law. Precisely what amount of reserves was thus released throughout the country has not been accurately estimated, and probably cannot be. It is, however, an undoubted fact that the release of actual cash was very large, and that the release of lending power as computed on the basis of reserves on the part of member banks was correspondingly larger. Member banks were thereby enabled to extend loans to their customers very much more freely than they had previously been able to do, while at the same time they were able to grant lower rates of interest in due proportion. The prevailing rate of discount for prime commercial paper in New York at the beginning of November was about 6 per cent, while other paper was considerably higher than that figure, and even more difficult conditions prevailed elsewhere. The opening of the reserve system enabled New York banks, because of the very great relief given to them

through the release of reserves, to reduce this rate largely, and within two weeks after the new banks had come into existence prevailing interest rates for the best paper went as low as $3\frac{1}{2}$ per cent and 4 per cent while acceptances, which had been provided for by the Federal Reserve act, were marketed at a still lower rate. In some parts of the South, northern bankers were able to grant accommodation as low as 4 per cent and in considerable amounts. In view of the greater ease and material relief which was thus accorded, the federal reserve banks were naturally not called upon to assist member banks with accommodation, such banks naturally refraining from asking aid when they themselves were fully able to meet the situation.

The opening of the reserve banks released, as already shown, a large amount of bank funds, and thereby rendered it possible to extend many loans which otherwise could not have been carried by the banks. It was also seen, soon after November 16, that the existence of the cotton fund, as was the case with the gold fund, had done its work by stimulating confidence and by leading to a more liberal extension of credit. With the cotton fund available for long-time loans, and with short-term credit much more freely extended by member banks in view of the reduction of national bank reserve requirements, it was possible for the reserve banks to open with full confidence that the work thus done in safeguarding the situation would relieve them from undue strain, while fully protecting the cotton-producers who were willing to pay a moderate rate of interest in order to carry their cotton until such time as would enable them to realize full market value for it.

As has been shown by the Secretary of the Treasury in his annual report,[1] an early phenomenon of the war was the issue by clearing-houses in many cities of clearing-house certificates. Simultaneously therewith large quantities of emergency currency were issued under the provisions of the act of 1908, which had been amended and extended by the Federal Reserve act, and which were still further amended by Congress on August 4, so as to permit the freer issue of notes, in the manner described at an earlier point in this discussion. As already indicated, the total amount of the

[1] *Report of Secretary of the Treasury*, December 7, 1914.

emergency currency taken out by associations had aggregated about three hundred and eighty million dollars, but it is probable that the clearing-house certificates were issued to a considerably larger sum. The channels of circulation were thus clogged long before the end of the summer, notwithstanding the fact that large quantities of gold and gold certificates were withdrawn and hoarded either by banks or by individuals. This condition of affairs made it certain that the reserve banks, upon their organization, would not be instantly pressed for the issue of reserve notes. Two factors combined to produce this result—the circumstance that many banks had placed their best paper with the national currency associations in order to protect emergency currency, and the further circumstance that the tax on this currency at the lower rate established by Congress would not, for some considerable time, be likely to approximate the rate of discount which every bank would have to pay to federal reserve banks in order to get the rediscounts that would enable them to obtain the notes they needed. Combined with these factors was, of course, the natural inertia which in all such cases tends to prevent the withdrawal of one kind of currency and the issue of another. Upon the organization of the federal reserve banks, moreover, the urgent pressure for note accommodation passed away as quickly as it had come. Gold reappeared in circulation at an early date, and the retirement both of the clearing-house certificates and of the emergency currency was undertaken. In those cities where rates of interest on clearing-house certificates were very high, the reserve banks aided in the retirement of the certificates remaining in circulation.

The emergency currency itself immediately began to be retired by its issuers, more than three hundred million dollars of it being now withdrawn, thus leaving in circulation today probably not to exceed seventy-five millions. It may be expected that with the lower rates of discount prevailing at the reserve banks, and with the continually heightening rate of taxation which the emergency currency has to pay, there will be a gradual conversion of such currency into federal reserve notes, at least for that portion of the supply which may be regarded as needed for some time to come. Thus far there has been little of this conversion for the

reasons already stated. Had the reserve banks been in operation at the beginning of August, they would naturally have supplied the great volume of currency which was called for; but not having done so, a field of business which would naturally be theirs has been temporarily taken from them by reason of the fact that it was occupied by the clearing-house certificates and emergency notes.[1]

[1] *First Annual Report of the Federal Reserve Board*, p. 16.

VI

The result of the restoration of trade, banking, and credit to earlier and more normal conditions has been steadily apparent. Cotton exchanges reopened on November 16, and stock exchanges opened for restricted trading shortly thereafter. In brief, by the close of the year, the phenomenal conditions growing directly out of the European war had been met and overcome. It is a notable fact that, under the wholly unusual circumstances prevailing, the recovery was so prompt and effective. What share in this early improvement is to be assigned to the organization of the new banking system and to the effectiveness with which the Treasury Department co-operated in meeting the needs of the country cannot accurately be stated, and will probably afford grounds for difference of opinion. That it was great cannot be denied. For the future, development will depend primarily upon the course of American commerce, and that, in turn, will be largely influenced by the conditions of war abroad. Barring some unexpected and unforeseen developments, it seems probable that the end of the purely financial disturbance has been reached, and that what is to ensue will have a bearing more largely upon conditions of capital investment than upon those affecting banking, currency, credit, or trade in the narrow sense. It is, of course, evident that two factors of enormous magnitude, whose precise influence cannot be measured, are to be reckoned with. These are (1) the tremendous destruction of capital caused by the European war; (2) the probable shifting of ownership of such capital, due to the large sale of American securities by foreign holders who desire to obtain the means with which to meet their private expenses, or to take up the enormous issues of government bonds which are being placed by every coun-

try in the world. There are many who believe that, as a result of the "unloading" of these securities, a new drain of gold may at any time make itself apparent; but so far as can reasonably be foreseen, this condition is hardly to be expected in the form in which it was made manifest during the past summer. It is more likely that any "drain" will be slow and steady, and that, instead of leading to an actual exportation of coin or bullion, it will simply necessitate the continued exportation of goods in exchange for securities purchased at low prices by American investors. The result will be an enlarged control by Americans over their own industries. This control will have been acquired by a shortening of the available supply of foreign capital. The consequence will be, undoubtedly, an increase in the rate which must be paid for long-time loans and corresponding expense in financing other enterprises, with probably an increase in prices due to the advanced cost of capital, which today constitutes so important an element in expense of production.

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